

**Suzana Salaru, Itaú:**

Good morning. We have two questions on the adoption of the subscription model. The first question is, was there any acceleration in adopting the subscription model to compensate for the slowdown in top line growth. Our impression is there was this acceleration.

The second question is, how does this migration function? Are these new clients or are you suggesting your existing clients to migrate to the subscription model. Thank you.

**Gilsomar Maia, TOTVS:**

Good morning Suzana. I'll start with your first question, which I think is quite appropriate in order to understand the impact of subscription

As we shown in the charts, we have seen a slowdown in licenses over the years. The subscription models interfere in this process as they slow down the growth of license fee revenue because, in a sense, when we acquire a company, we direct a part of our pipeline to it, which converts these opportunities into sales. So we are "transferring" sales that would traditionally be made through the license model to the subscription model.

Hence, the subscription model has actually been affecting the growth of license fee revenue for some time now.

So, part of the quarter's results related to licenses revenue were, of course, affected by the migration process, but as Mafra pointed out, sales related to large clients were more relevant.

One example that could help us understand this is when we take our license fee revenue for 12 months, at around R\$360 million, which gives an average of R\$90 million per quarter. And we had license revenue of R\$80 million this quarter. There was a gap of R\$10 million from this average.

A shortfall of R\$10 million in license revenue in a single quarter cannot simply be explained by this process. What is happening is a gradual process. This is related to the large accounts that were not signed up this quarter.

**Suzana Salaru:**

So there was no continuous acceleration of the migration process as has been happening in recent quarters? It is this that I wish to get clarified.

**Gilsomar Maia:**

I'll soon come to your question. To conclude, large accounts play an important role in this 9% *decline in licenses during the quarter.*

*To give you an idea, the last time we earned license revenue of R\$80 million in a quarter, if I remember right, was in 2Q12, more than two years ago. This shows that R\$ 80 million is a point outside the curve in relation to what the company has been earning in recent times. The pace of growth of subscriptions has been gaining momentum over time. The chart even shows this.*

And then, as I commented, you must remember that a few quarters ago, when we talked about our SaaS offering, which we call Series 1 for micro businesses, which has a monthly fee of R\$

99 per user; also initiatives for a negotiation process, even of license sales, in order to have greater flexibility in discounts on licenses, but preserving the maintenance services.

In other words, we have been giving preference to this recurring revenue for some time now. Also, as I explained sometime back, the companies that we acquired also share this characteristic of practically no license revenue but heavy share of maintenance revenue.

The combination of all these factors is what shows that subscription revenue has in fact gained significance over time. It has grown but I cannot explain the quarterly result solely on it. I think it is a gradual ongoing process.

We plan to intensify efforts on it but will not stop selling licenses to clients who wish to buy licenses. It is important that we make this very clear.

What we see is that many companies will require licenses for a long time and we will not stop selling licenses to them. The transition to SaaS will be made by us in a proactive manner but we will not lose any business.

And the migration of existing clients will be a natural process. We will not force them. Of course, we will give preference to clients that show interest in this.

**Suzana Salaru:**

Perfect Maia, thank you.

**Valder Nogueira, Santander:**

Good morning. I find this explanation of yours, delinking what happened in the quarter with the path you are taking, interesting. I think many people must be associating the steps you are taking with what happened in the quarter.

I understand it and I would like to know if it's not necessarily the case. My question is: I understand that the chart on page four clearly shows that there was a trend of migration to monthly payments, Series 1 etc., which was your organic/inorganic mix.

But the most important question is: What was the key variable for you to decide to promote this model? Was it an internal variable or an external variable? Is it that the license market is in difficulty or is it that the subscription market with its benefits is perhaps more important in this dynamic? Is there any vertical where you think the entry of this model is more difficult or less difficult. That's my first question.

**Gilsomar Maia:**

Good morning, Valder. Thank you. I'll start with your first question related to the quarter. In fact I think it is connected to Suzana's question and I could some additional explanation.

As I commented to Susan, there in fact exists a component that has migrated from licensing to subscription at a gradual pace over the quarters. This cannot be denied. The companies that we acquired already have this model. They have grown at a higher pace than the Company's average.

We have noticed this exclusively monthly payment model has been well received in the segment in which these operate. As you commented, the Series 1 initiatives also show that micro enterprises too have received this model quite well.

We know that SaaS is a global trend in the industry and cloud is also included in this concept. Of course we must put it into context. We cannot simply pick up international trends and apply them to our reality. We must know how to adapt these trends to our reality.

So this set of trends and our perception - that the market is beginning to understand that you don't own the software but only pay for the use - is gaining significance. Cloud too is becoming more common in the daily lives of people.

Looking ahead, the company sees that this too is beneficial for its business. We have started noticing that the time is already favorable for us to take a more proactive approach in this regard.

So there is a bit of external reality. Of course, when we put this into the context of Brazil, we also create an alternative for our sales force, for them in terms of negotiating power and of reducing barriers to entry, especially in smaller companies.

In fact, it is this group of factors that led us in this direction, Valder. There is no single reason that was decided or which led us to decide on taking this direction.

**Alexandre Mafra:**

Valder, let me add to that. There are two aspects. One was already very well explained by Maia but I'll just complement it anyway. We are in no way satisfied with the results of the quarter. We believe we can do much more than was done this quarter, due to all the economic reasons etc. that happened.

As for your question on the level of adoption per segment, I feel that rather than looking at the segment, it is about looking at the size of the company. Small companies, which adjust license purchases to their cash flow, are more likely to use this model. In the case of bigger companies, which work with budgets and capex, this needs to gain more maturity for adoption to be a natural process.

**Gilsomar Maia:**

It's also true Valder that there is resistance in a few situations to the question of the client still having ownership of the software, because when they acquire the license, "the software is theirs". There is this issue; but remember that our software supports the critical operations of our clients.

We know that some clients may choose this model in certain solutions and remain with the license model for others. There is no hard and fast rule.

But returning to the points you raised about the key variable, I think it's these. As for the quarter, of course this process does not explain the size of the gap in one quarter.

As Mafra said, I don't think the vertical approach influenced that much. We know that bigger companies, which are oriented towards Capex, perhaps a few government-owned companies could require more Capex. Also, companies that recently invested in licenses will probably take longer to adopt this model.

**Valder Nogueira:**

And that's exactly the reason why you said that license revenue doesn't become zero but remains at a certain level. It will continue to exist in the future.

My second question, Maia and Alexandre, is what you expect from the dynamic of service revenue in this new model?

**Gilsomar Maia:**

Service revenue is not affected much by this process. The chart helps to prove this, because license revenue really took off with services.

There was a certain misconception when the software as a service concept was introduced in the market, that there will be no deployment and that it will be an entirely plug-and-play solution, etc. This, based on our practical experience, is highly true for Series 1 solutions targeted at micro enterprises. This is, in fact, a subscription where the client buys the service with a credit card and accesses it via the Internet.

But this is not something very practical in case of bigger companies, where the complexity of client's operations and systems, as well as the configuration, requires you to understand the client's routines and parameterize the systems. Thus, service continues to play a very important role.

And also in sales, because in a solution like this, in many cases clients will not feel comfortable with the coldness of a pure and simple relationship via the Internet. I think there will be a combination of two things. But the role of our franchise network in our distribution system remains important for us and so is the role of services.

In some situations, we see that due to the reduction in initial investment that is not made on account of licenses, the client could have some surplus for a broader implementation in the initial stage, which also helps increase our recurring revenue and client loyalty.

Hence, I see that service is not much affected by the model. In fact, it could even stand to benefit. The impact on it is already more related to what we have been working on for some time now in services, which is making our implementation quicker.

This is highly linked to the improved efficiency of our implementation and also to segmentation, because as we increasingly specialize our software, implementation tends to be quicker; On the other hand, the client normally has a certain amount of investment in mind that he can allocate on something like this and he can, in fact, have a broader initial implementation than we had in the past, for example.

**Valder Nogueira:**

Thank you.

**Diego Aragão, Morgan Stanley:**

Good morning. Thank you for your question. With regard to version 12, could you tell me the percentage of clients that already use this version? It's because investors often ask us what percentage of your existing clients have been using, or continue to use, a legacy system. I'd like you to take this opportunity to comment on this. This is my first question. Thank you.

**Gilsomar Maia:**

Diego, I couldn't hear clearly the final part of your question regarding legacy systems. Could you repeat it?

**Diego Aragão:**

Yes, I want you to inform the percentage of your existing clients that still some kind of legacy system.

**Gilsomar Maia:**

I understand. Version 12 was made available to clients on September 30. This is something recent. We have a small number of clients who are in the pilot project of migrating to this version 12.

Our maintenance contract gives clients the right to remain with up to two older versions. That is, the client has support for upgrades and technical support for up to two older versions.

This allows us to have clients who are at most four years behind the latest version. Because if you consider that we have a cycle of about a year and a half for each version, clients who are two versions behind will probably be lagging three to four years. This is a natural process for us.

With Version 12, we are introducing what we call "soft updates" which, to help you understanding what are talking about, is somewhat similar to when we receive updates for our Windows, for example. There are those update packages, which come "flagged" by default but you can "unflag" a few updates and don't execute them for whatever reason.

So, our client now has in Version 12 this possibility of selecting which update he wants to execute at that moment. This enables us to reduce the migration efforts. In fact there will be no more migrations because the next updates will be done in this manner. Thus, the client will start making updates and their version will be very close to the latest version that we supply to a new client, for example.

This, Diego, should reduce what you called legacy systems because some clients migrate to new versions slower because they take time to understand all that is new in the new version which could affect their routines. This requires more of the client's time.

As we proceed with this "soft update" approach, where clients can make partial updates, we are actually breaking up this migration into small parts and the process becomes smoother for the client. This should enable the client to actually get close to the latest version of our products.

**Diego Aragão:**

I understand. Perfect, Maia. Thank you. The second question is about the dynamic of large account clients. Have they postponed? Do you feel that a few contracts are being postponed or canceled?

**Gilsomar Maia:**

The vast majority of all this is postponement. In fact, we notice that our competitors dealing with large companies, or mid-size to large companies, have even publicly announced that they are facing a similar situation. This also proved our sales team's perception that these opportunities were not lost to one competitor. These are still alive.

It is difficult for us to know if these are pent up opportunities that were postponed by the costumers, which will be closed at one shot or over a period of time. Going by the stance taken by companies, I believe they have adopted a conservative approach.

I believe that the Company should go proceed towards its historic average. Of course, the sales force's obligation is to try to recover these opportunities and translate them into sales.

I don't wish to sound overly optimistic, especially regarding this R\$80 million of licenses we had, that we will be able to return to a natural pace and also recover what happened in the past. Once again, we have to go after it but we have to exercise caution.

**Diego Aragão:**

Perfect, Maia. Thank you.

**Daniel Federle, Credit Suisse:**

Good morning everyone. My first question is about guidance. You eliminated guidance this quarter and I'd like to know if you intend to provide guidance once again in the short term. Does it make sense or, given the current scenario, is it very difficult to predict the Company's recurring margin, growth or even international operations. And in the case of international operations, if there is really any chance of it gaining greater significance in relation to the total.

The second point, with regard to the decline in license sales, it seemed to me that the effect was greater on existing client base than on new clients. I'd like to know why the macro scenario affected the base clients more than new clients this quarter. Thank you.

**Gilsomar Maia:**

Good morning Daniel. Starting with guidances, as mentioned to Suzana, these were based on the premises of growth of both the country and the company.

Given the scenario of a country with poor growth, both this year and last year, and considering that SaaS subscriptions have been increasing gradually, it didn't make much sense being stuck with the same premises that were valid in another scenario.

The Company clearly made a choice, because if it went solely after margin, for example, from the next year, perhaps this was not the most recommendable way. It should think in another direction, of earning margin by merely scaling down its structure and settle for a slower pace of growth. This is not the case here.

What the company proposes is, in fact, to lay the emphasis on this subscription model and pave the way for better growth, including with the regard to the future, because the subscription model, as we commented, slightly hampers revenue growth in the short term because we basically swap upfront revenue for revenue that comes in on a monthly basis over the years. But as we have the client retention capacity from a given point, we'll be able to

monetize and increase the profitability of the installed base because we would be able to charge more over the years than what we would solely under the licensing model.

That was the main reason regarding guidance, because I think it would not give the necessary flexibility for the Company to invest and encourage adoption of this model.

With regard to importance of the international market, first it will be impacted by the subscription model; even SaaS is already being affected by it. Secondly, as we are working on this in Brazil, note that we give a percentage of significance of the international market in relation to the total revenue of the Company.

If I'm focusing on subscription, it could slightly affect the growth rate of total revenue in the short term, and this interferes in calculating this percentage of the international market.

But generally speaking, regardless of the numbers, the Company's thinking on the international market remains the same. Brazil remains the mainstay of the company's operations and strategy, and the international market, especially Latin America, comes in a complementary strategy to Brazil because it is the natural route for expansion for Brazilian companies that foray into the international markets.

For us, including the Brazilian operations, it is important that we operate in the rest of Latin America.

As for your last point about the decline in the base, whether SaaS affects more the decline in the base clients, we have large accounts as you very well know. We have clients of all sizes. Of course, in terms of numbers, we have many more small and mid-sized clients than mid-large and large clients.

These clients too have an important role in our installed base, especially considering the rising manpower costs over the years. Companies try to become efficient by investing in information technology.

There was a time in Brazil when it was easier to hire two or three people to perform an activity than to automate that activity, but this is long gone. In fact, it is part of our discourse for the sales team. And it's there that we very often convince companies to invest in technology.

During the period between the World Cup and the elections, we noticed that the larger companies hit the brakes very hard. You who talk to companies, including from other sectors and even large companies, probably would have perceived this generalized behavior among these companies. Yes, this did affect sales in the base.

On the other hand, smaller clients – the small and midsized companies – who are our typical clients, were probably less affected than the bigger clients by the macro scenario and delivered a more consistent volume. So much so, these 900 clients that we added are well in line with the average we have added in recent years.

This resulted in the addition of new clients being possibly less affected than sales to base clients.

**Daniel Federle:**

Thanks Maia. I would just like to clarify one point: With regard to guidance, to maintain the company's flexibility, ideally a new guidance in the short term should not be disclosed. Is that it?

**Gilsomar Maia:**

Yes, that was a part of your question on guidance. What we understand is that we need a little more flexibility now. So it's not possible to give an exact margin.

I don't see the company's margin changing or going to a completely different level from what we have seen. So much so that if you check, in this same period that we analyzed the evolution of the three revenue lines, you can see stable margin, even on annual bases.

As I commented to Valder and Suzana just now, we will continue to sell licenses to clients that request licenses. We don't see companies changing their requests completely overnight.

The fact is we will give preference to the subscription model but will not stop selling licenses. This will enable a smooth transition to subscription.

Of course, on a quarterly basis we could have strong sales volume of licenses in a quarter and, as was the case in 1Q, a strong recovery in margin. The opposite too could happen, of subscription picking up pace and as a result, licenses losing a bit more.

But between one scenario and the other, I don't see margin deteriorating significantly, more than we have seen, especially on an annual basis.

In fact, providing another guidance here wouldn't even be beneficial to the company at this moment when it is in this transition and needs a little more flexibility.

**Alexandre Mafra:**

I have an important point to emphasize which is, regardless of the discontinuation of guidance, we will continue to focus heavily on reducing costs and expenses. I think Maia put it very well: we don't see changes in our margin but we will continue to do our homework regarding costs and expenses diligently.

**Daniel Federle:**

Perfect. A quick recap, to see if I understand your second question: license revenue from the base was affected because the share of large clients in the base is greater than that of new clients. Is that it?

**Gilsomar Maia:**

Yes. And then, Daniel, there is the following effect: As we had this decrease in license sales, it increased the importance of these recurring revenues that are also part of our license. The ticket in these monthly fees is very low and so this heavily brings down ticket.

**Daniel Federle:**

OK. Thank you.

**Luiz Azevedo, Bradesco:**

Good morning. My question is related to the international operation. I want to know: Did it reach breakeven? You had slightly changed the product portfolio, is your idea to focus on

SaaS abroad? How do you look at this going forward, though you can't commit to giving guidance? Could you give more details?

The second question is regarding M&A. You had an expense of R\$2.7 million this quarter. I wish to know if there was any specific reason for this and how is the pipeline going forward. Thank you.

**Gilsomar Maia:**

Good morning, Luiz. With regard to the international market, we were moving towards breakeven, which was perhaps not helped by the scenario in Argentina. Incredible as it may see, looking back, Argentina managed to get slightly worse than it already was earlier. But the fact is the Argentina operation is getting closer to reaching breakeven. We are in this direction and there is no change regarding this.

The change in the portfolio we made some time back in the international market is one of the elements that helped us move towards breakeven, because we don't even have the scale outside Brazil to sustain the broad portfolio we have here in Brazil. This implies a heavy cost for sustaining this portfolio, given the level of revenues we earn in the international market.

The reduction in the portfolio in the past, whose scope was restricted and more focused than is more relevant in these Latin American countries, was a very important factor for us to move towards breakeven.

Talking specifically of M&A, the M&A expenses we had this quarter are related to spending with projects, with cases that are in our M&A pipeline.

I can't give the details of these projects but these expenses are related to consulting work, diligence, audit and also several product audits, and not just numbers. There is a series of expenses related to our M&A process.

As I mentioned in previous quarters, our M&A process is relatively long since an in-depth analysis is made. And these expenses that we booked this quarter are related to this.

**Luiz Azevedo:**

I wish to know how you are looking at your M&A pipeline for the future.

**Gilsomar Maia:**

To recap, our M&A pipeline is divided into three major groups. One that is closely linked to the Brazilian reality, is the pipeline of companies that work with vertical solutions, which explore industry niches. In most cases, these companies are highly regional but with a level of specialization and a highly specialized team. I would say that the biggest portion of pipeline portfolio is related to this profile.

The second group is related to the international market, especially Latin America. North America could be included sometime, but this will not be in the immediate future. Right now, the core focus is on Latin America, to accelerate the process of strengthening our distribution channels in the rest of Latin America through M&A. Brazil shows how important distribution is in our market.

And finally, the third group is more related to meeting technological demands. The ventures team also plays an important role because we can make typical M&A investments, of acquiring

the control of an operation or we can also make minority investments, more in the form of venture capital, as we did at GoodData.

All these three pipelines have an interesting list of options that we have worked on, but we are taking a highly disciplined approach and the conclusion of these operations will take place naturally.

**Luís Azevedo:**

Thank you.

**Yannick Bergamo, Banco Fator:**

Good morning. Do you intend to give in the future more details on the share of the subscription model in license revenue in terms of average ticket, number of clients affected? Until then we could track this evolution that you are mentioning.

**Gilsomar Maia:**

Good morning, Yannick. That's exactly our idea. What we are doing is to build a history of these indicators for you, because giving only the present may not be much very useful. Perhaps it is important for you to see if there is any trend in your modeling and include a revenue curve, but our idea is actually to split it.

I don't know if by 4Q we will have this history ready with the degree of consistency checked that we are working on, but that's our idea. The sooner we can, we segregate it and give you operational data also of new clients and number of paying clients and average ticket so you can have a vision in terms of financial modeling.

Specifically this quarter, as I commented earlier, I think the reduction in conventional license sales increased these recurring revenues that make up our license. This further increases the importance of your request.

The fact that in the past its importance was lower, so we didn't find it important to give it in detail but I think that from now on, this information will be even more important for you. We are working on this.

**Yannick Bergamo:**

Perfect. Thank you.

**Eduardo Cancian, Banco Votorantim:**

Good morning. My question is also related to license revenue. The decrease in revenue is related to the subscription model, where you said 20% to 30% of the sales happened, but also due to market factors – division by a few clients and also smaller clients.

Given the current market situation, the tendency for the next quarter, or if we could look ta next year, is to maintain this level of R\$80 million in license revenue or a return to the level of R\$90 million, which is what you delivered in recent quarters?

**Gilsomar Maia:**

Good morning Eduardo. I believe, given the company's history, without giving any type of guidance during the call, that the company has bright chances of returning to its average.

As I mentioned just now, given the market scenario, I don't think there will be a strong recover in licenses. I believe that there are greater chances of moving towards the average that we delivered in recent times.

However, our duty is to recover, if possible, all that was left behind.

Once again, I know I'm being repetitive, it's not a simple task given the post-election period, etc. I think many are observing and trying to understand how the next year will turn out.

We have especially seen bigger companies have greater difficulty in budgeting for 2015 because the variables that could affect the scenario next year for these companies are more volatile.

It's also a fact that historically these companies have used the budget leftovers at the end of the year. When you have a more restricted budget for the next year, many of these companies use these budget leftovers at the end of the year because they don't know of the IT areas will have any budget allocation the next year.

But this was in the past, Eduardo. It's difficult to categorically state that it will continue this way. I believe that the average is a good reference point for us.

**Alexandre Mafra:**

Based on all that we have seen, it seems this 3Q was much more a point outside the curve than a trend.

**Gilsomar Maia:**

Exactly. As I mentioned earlier, we haven't seen a level of R\$ 80 million since 2Q12, if I remember right. It is in fact a point outside the curve.

**Eduardo Cancian:**

OK. Thank you for your answer.

**Operator:**

There being no further questions, I now turn the floor back to Mr. Gilsomar Maia for his final remarks.

**Gilsomar Maia:**

I wish to thank you all for your presence and remind you that on November 6, we will have a public meeting at the head office of the Company, at Avenida Brás Leme, 1717. It will be in the morning, we will have breakfast at 8:30 a.m., but the meeting will actually start at 9:00 a.m. and we plan to finish it by around 11:00 a.m. It will be a two-hour chat and we will be glad to have you with us. Thanks once again and have a nice day.

**Alexandre Mafra:**

Thank you. Have a nice day.

**Operator:**

Thank you. That concludes TOTVS' conference call. Thank you for participating and have a good day.

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